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RUCNCLS/SOUTH AND CENTRAL ASIA COLLECTIVE
RUEHZL/EUROPEAN POLITICAL COLLECTIVE
RUEHBJ/AMEMBASSY BEIJING 0497
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UNCLAS SECTION 01 OF 03 ASTANA 000166

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E.O. 12958: N/A

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SUBJECT: KAZAKHSTAN: MINISTRY OF ENERGY OFFICIAL DISCUSSES NATURAL
GAS MARKET DYNAMICS

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11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: On January 21, Energy Officer discussed the production, marketing, and sale of Kazakhstani gas with an official from the Ministry of Energy and Mineral Resources. He described the role of market intermediaries KazTransGas, KazRosGas, and Gazprom, disclosed prices Kazakhstan pays to import gas from Russia and Uzbekistan, announced Kazakhstan would soon increase the transit fees it charges Gazprom, praised Russia for being a reliable partner, and criticized Uzbekistan for dramatic price increases and unpredictable supply. END SUMMARY.

THE STRUCTURE OF KAZAKHSTAN'S GAS MARKET

13. (SBU) On January 21, Energy Officer met with Timur Imashev, Director of the Gas Industry Department in the Ministry of Energy and Mineral Resources, to discuss the gas market in Kazakhstan. After numerous attempts to explain the convoluted connections and overlapping owners of Kazakhstan's gas market, Imashev hurriedly took out a blank sheet of paper, scribbled a series of circles and arrows, and explained that there are two main market mechanisms for the transportation and sale of gas in Kazakhstan, one in the west and one in the south of the country.

KAZROSGAS: MORE THAN A MERE MIDDLEMAN

14. (SBU) Kazakhstan produces approximately 30 billion cubic meters (bcm) of gas annually, including liquefied natural gas, natural gas liquids, and dry natural gas. The operators of large fields in Karachaganak in Western Kazakhstan oblast, Tolkyn in Mangistau oblast, and Tengiz in Atyrau oblast sell their natural gas to KazRosGas, a 50-50 joint venture of KazMunaiGas (KMG) and Gazprom. (NOTE: KazRosGas was established during a state visit to Kazakhstan by Russian President Putin on November 28, 2001. Its mandate is to manage Kazakhstan's gas import and export operations; treat raw gas at processing plants; explore, develop, and operate gas fields; secure natural gas transport routes; conduct gas swap operations;

and operate joint venture projects in natural gas transportation. KazRosGas is registered in Astana and maintains offices in Moscow and Zug, a well-known tax haven in Switzerland where Ukraine's notorious RosUkrEnergo is also registered. Kairat Boranbayev is Chairman and General Director; other senior executives include Asia Sirgabekova, First Deputy Director for Economic Issues; Nurlan Abdrasulov, First Deputy Director for Marketing; and Malik Kushaliev, Deputy Director for Legal Affairs. Kushaliev is also the point of contact for a company called Centrex Central Asia Gas, which is registered in Baar, Switzerland. END NOTE).

15. (SBU) According to Imashev, KazRosGas transports gas from Karachaganak, Tolkyn, and Tengiz to Orenburg, Russia, where it is processed for commercial sale. KazRosGas then imports the processed gas into Kazakhstan and sells approximately 10 bcm to regional gas distribution companies such as KazTransGas-Aimak, a wholly-owned subsidiary of KMG, for domestic users in western Kazakhstan. KazRosGas also sells up to 1.2 billion cubic meters to Gazprom for Russia's domestic consumption via the Central Asia Center (CAC) gas pipeline, which is operated by Intergaz Central Asia (ICA). (NOTE: ICA is a wholly owned subsidiary of KazTransGas and the monopoly operator of gas transportation pipelines in Kazakhstan. ICA manages the network of gas pipelines in Kazakhstan on the basis of a 20-year concession agreement with the government, which is valid until 2017. ICA's total (both domestic and export) gas transportation volume plan for 2007 was 124.8 bcm. KazMunaiGas, not Gazprom, owns the 900 kilometers of CAC pipeline on Kazakhstani territory. END NOTE).

TENGIZCHEVROIL GAS PRODUCTION, MARKETING AND SALES

16. (SBU) In 2008, Tengizchevroil (TCO) produced approximately 6.8 billion cubic meters (bcm) of gas. According to TCO's Commercial Manager for Products, Marketing and Transportation, Mark Heinemann (protect), in 2008, TCO sold 1.84 bcm to more than 16 domestic customers -- including industrial enterprises and regional

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governments in Atyrau, Mangistau, and Western Kazakhstan -- and 1.92 bcm to KazRosGas for export. TCO used the balance of production (more than 3 bcm) for re-injection and operational purposes. TCO's domestic sales were concluded directly with end-users and the gas was transported via pipeline between Tengiz and Kulsary and via the CAC.

17. (SBU) Heinemann said that TCO's export sales were handled by KazRosGas and one other, unnamed buyer and transported via the CAC. Heinemann noted that Gazprom controls all of the gas pipelines in Russia and does not allow other parties such as TCO to make direct sales to customers in Russia. He confirmed that TCO sells gas for export to KazRosGas, which sells it to RosUkrEnergo, the only company authorized by Gazprom to bundle gas from Central Asia and package it for onward shipment and sale. RosUkrEnergo then sells the bundled gas to UkrNaftoHaz, which sells it directly to customers in Ukraine. Heinemann said that Gazprom has strictly prohibited any gas from Central Asia to be sold to markets or customers in Western Europe and he expects that arrangement to continue.

18. (SBU) TCO also produces butane and propane liquid petroleum gas (LPG), which it sells to domestic buyers in Kazakhstan. According to Heinemann, in 2008, TCO produced approximately 851,000 metric tons of LPG. TCO sold 58,000 metric tons of LPG to customers in Kazakhstan and 801,000 metric tons to customers in Europe and Turkey. The difference of 7,000 metric tons came from inventory. All deliveries of LPG were made by LPG rail tank car.

UZBEKISTAN GAS SUPPLIES KAZAKHSTAN'S SOUTHERN REGION

19. (SBU) KazTransGas buys natural gas from Uzbekistan and transports it to customers in the south-eastern region of Kazakhstan. Imashev said that Kazakhstan typically buys more gas than it needs from Uzbekistan and swaps a certain percentage with Russia (he said 100 million cubic meters, but that may have been merely for illustrative purposes). KazTransGas sends the swap amount northward to Alexandrov Gai in Russia via the CAC, where Gazprom provides an equivalent amount to KazTransGas for domestic use in the western region. Imashev had high praise for Russia's

role in these transactions, saying, "They meet us more than half way and handle all of the customs paperwork to import and export the gas."

WHAT PRICE DOES KAZAKHSTAN PAY FOR GAS?

¶10. (SBU) Karachaganak Petroleum Operating B.V. representatives said they sell sour (unprocessed) gas to KazRosGas for approximately \$20 per thousand cubic meters (tcm). Imashev confided that KazTransGas pays approximately \$80/tcm for clean, dry gas from Orenburg. He said that KazTransGas pays approximately \$300/tcm for the Uzbek gas delivered to Kazakhstan's southern domestic market, nearly twice the amount it paid in 2008. Imashev conceded that Uzbekistan has every right to charge what the market will bear, but he complained that since there is no firm contract in place, Uzbekistan is free to change the terms and delay or cut supplies at will, without penalty. He said Uzbekistan will even "cut off the tap from time to time. They're playing games with us." (NOTE: KazTransGas is building a west-south gas pipeline from Beineu to Bozoi to Akbulak to avoid importing gas from Uzbekistan. Construction has been delayed because of the financial crisis, but this remains a high priority project for KMG. END NOTE). Minister of Energy and Mineral Resources Sauat Mynbayev would not disclose the price Kazakhstan will pay to import gas from Russia, but he did tell journalists on January 21 that KMG signed a deal with Gazprom on December 31, 2008, to supply 4.6 bcm to the Kazakhstani domestic market.

EUROPEAN PRICES COME TO CENTRAL ASIA

¶11. (U) On January 21, Prime Minister Karim Masimov ordered the Ministry of Energy and Mineral Resources to calculate the impact of Russia's anticipated shift to European pricing for gas. "There is

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no way out of this situation," he said. "We need to be very well prepared for this transition. We need to know what it will cost us." Masimov then added, "I took part in the gas dispute between Russia and Ukraine and there is one very important conclusion we must draw: Russia will move to European prices at home and with exports to Ukraine and other countries in 2011." (NOTE: In January, Gazprom signed contracts with Uzbekistan and Turkmenistan to purchase natural gas at approximately \$301/tcm in the first quarter of 2009, more than double what it paid in 2008. END NOTE).

KAZAKHSTAN RAISES TRANSIT TARIFFS

¶12. (U) Perhaps in anticipation of paying higher prices for Uzbek and Russian gas, on January 22, KMG increased the transit fee it charges Gazprom by 21%, from \$1.40/tcm per 100 km to \$1.70/tcm per 100 km in 2009. (COMMENT: This rate is below European market rates, but is approximately the same amount that Ukraine charges Gazprom to transit gas to Europe. END COMMENT).

GOVERNMENT ANNOUNCES BAN ON GAS FLARING

¶13. (U) On January 16, the Minister of Environmental Protection, Nurlan Iskakov, announced that the Ministry would stop issuing mineral resources licenses to oil companies if they fail to comply with gas utilization standards. "There will be no licenses issued to any of the 30 oil companies after 2010 unless they cease all gas flaring," he said at a meeting of the environment protection committee. In 2008, Iskakov claimed companies in Kazakhstan flared 6.9 billion cubic meters of natural gas. He said that China's National Petroleum Corporation already incurs a fine of \$80,000 per day for excessive flaring.

¶14. (SBU) The Ministry of Energy's Imashev said the government is serious about reducing emissions, but he admitted that zero emissions is an "impossible standard." Imashev said that gas flaring is necessary for safety reasons to provide an emergency outlet to relieve pressure in the well. He said that the Ministry of Energy has made this point to the Cabinet and will continue to discuss and debate the Ministry of Environmental Protection's new measure.

¶15. (SBU) COMMENT: Tracing the steps and stages of the gas market in Kazakhstan is not easy to do. In particular, precious little information is publicly available about the trading companies that market and transport Kazakhstan's natural gas, both domestically and to export markets. Even privately, foreign companies and government officials are loath to disclose proprietary information about price, volume, and fees. Nevertheless, from the information we have gathered to date, it is clear that intermediaries such as Gazprom and KazRosGas play a critical, and lucrative, role getting Kazakhstan's gas to market and have significant influence over who gets what, when, and how much they pay. END COMMENT.

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